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UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF WASHINGTON  
AT SPOKANE

CITY OF ROYAL OAK  
RETIREMENT SYSTEM, et al.,  
Individually and on Behalf of all  
Others Similarly Situated,

Plaintiffs,

v.

ITRON, INC., MALCOLM  
UNSWORTH, and STEVEN M.  
HELMBRECHT,

Defendants.

No. cv-11-077-RMP

CLASS ACTION

MEMORANDUM OF LAW IN  
SUPPORT OF MOTION TO  
DISMISS CONSOLIDATED  
COMPLAINT FOR VIOLATIONS OF  
FEDERAL SECURITIES LAWS

NOTE FOR MOTION CALENDAR:  
February 23, 2012  
2:00 p.m.

ORAL ARGUMENT REQUESTED

MEMORANDUM OF LAW IN SUPPORT OF  
MOTION TO DISMISS CONSOLIDATED  
COMPLAINT

10145-6012/LEGAL21929582.1

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MEMORANDUM OF LAW IN SUPPORT OF  
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COMPLAINT – iv

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MEMORANDUM OF LAW IN SUPPORT OF  
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COMPLAINT – v

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1 Defendants Itron, Inc. ("Itron" or the "Company"), Itron's former Chief  
 2 Executive Officer Malcolm Unsworth ("Mr. Unsworth")<sup>1</sup> and Itron's Chief  
 3 Financial Officer Steven Helmbrecht ("Mr. Helmbrecht," and with Mr. Unsworth,  
 4 the "Individual Defendants," and collectively with Itron, "Defendants")  
 5 respectfully submit this memorandum of law in support of their motion to dismiss  
 6 with prejudice Plaintiff's Consolidated Complaint for Violations of Federal  
 7 Securities Laws ("Consolidated Complaint" or "CC," ECF No. 26).  
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## 17 I. PRELIMINARY STATEMENT

18 On February 16, 2011, Itron announced its financial results for fiscal year  
 19 2010. It reported full year revenue of \$2.26 billion, net income of \$105 million  
 20 and earnings per share of \$2.56. Knowles Decl., Ex. A at 5-6. At the same time,  
 21 Itron announced that it had restated its financial results for the first three quarters  
 22 of 2010, primarily to defer \$6.1 million of extended warranty revenue that had  
 23 been prematurely recognized on a single contract. *Id.* The effect of the  
 24 restatement was to reduce Itron's revenue for the first three quarters from \$1.644  
 25 billion to \$1.638 billion—a reduction of \$6.1 million, or 0.37%. CC ¶ 68.  
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 41 <sup>1</sup> On August 31, 2011, Itron announced the retirement of Mr. Unsworth.  
 42 See Ex. D to the Declaration of Sean C. Knowles In Support of Motion to Dismiss  
 43 Complaint for Violation of Federal Securities Laws ("Knowles Decl."), filed  
 44 concurrently herewith.  
 45  
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 47

1 Disregarding the fluff and hyperbole, the Consolidated Complaint contains  
2 no facts to support an assertion of fraud. Indeed, Plaintiff's claim rests entirely on  
3 the February 16, 2011 announcement of the extended warranty revenue  
4 restatement, which was followed one week later by the filing of the initial  
5 securities fraud complaint in this lawsuit. Lacking any particularized facts to  
6 support the proposition that the Individual Defendants intentionally failed to defer  
7 the extended warranty revenue from one contract, Plaintiff pleads backwards  
8 from the announcement and implausibly alleges that the Individual Defendants  
9 "must have known" about the accounting error. But the Private Securities  
10 Litigation Reform Act ("PSLRA") does not allow pleading by speculation or  
11 hindsight. Instead, the PSLRA requires Plaintiff to plead particularized facts  
12 from which to infer that the Individual Defendants intentionally or recklessly  
13 permitted premature recognition of extended warranty revenue.  
14

15 Plaintiff has had six months since the initial complaint was filed to  
16 investigate and prepare the Consolidated Complaint. But the Consolidated  
17 Complaint, just like its predecessor, relies entirely on a single fact—the February  
18 16, 2011 announcement of the extended warranty revenue restatement—to  
19 support Plaintiff's nonsensical fraud theory. The Consolidated Complaint is  
20 notable in that it:  
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- 1 • *fails* to allege that either Individual Defendant sold any of his
- 2 considerable Itron stock holdings during the ten-month class period;
- 3
- 4
- 5 • *fails* to allege that any "confidential witness" has information that
- 6 purports to demonstrate that either Individual Defendant knew about
- 7 the prematurely recognized extended warranty revenue prior to the
- 8 discovery leading to the restatement;
- 9
- 10 • *fails* to allege that the extended warranty revenue at issue in the
- 11 restatement was fictitious and instead concedes that the restatement
- 12 concerns only the timing of recognition of that revenue; and
- 13
- 14 • *fails* to allege that any of the investment analysts who follow the
- 15 Company and wrote reports after the February 16, 2011
- 16 announcement commented negatively regarding the extended
- 17 warranty revenue restatement.
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31 The Consolidated Complaint does not come close to satisfying the

32 PSLRA's heightened pleading requirements. Plaintiff fails to allege particularized

33 facts demonstrating that the Individual Defendants acted recklessly or with

34 fraudulent intent with respect to the timing of the recognition of the extended

35 warranty revenue. Lacking particularized facts, Plaintiff instead relies on vague,

36 conclusory allegations concerning the Individual Defendants' positions at the

37 Company, their signatures on certifications required by the Sarbanes-Oxley Act

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1 ("SOX"), and their purported "motive and opportunity" to engage in securities  
 2 fraud. But Congress established the PSLRA's heightened pleading standard to  
 3 prevent claims of "fraud by hindsight," which is exactly the thesis of the  
 4 Consolidated Complaint. If Plaintiff had developed any facts to support a fraud  
 5 claim since the original complaint was filed, it would have pled them in the  
 6 Consolidated Complaint. Because Plaintiff has not met the pleading requirements  
 7 for its securities fraud claim, the Consolidated Complaint should be dismissed  
 8 with prejudice pursuant to Federal Rule of Civil Procedure ("Rule") 9(b), Rule  
 9 12(b)(6) and the PSLRA.  
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## 21 **II. BACKGROUND<sup>2</sup>**

### 22 **A. The Parties.**

23 Itron is the world's leading provider of smart metering, data collection and  
 24 utility software systems and delivers end-to-end smart grid and smart distribution  
 25 solutions to electric, gas and water utilities around the globe. Knowles Decl., Ex.  
 26 A at 6. Mr. Unsworth was the Company's President and CEO, and Mr.  
 27 Helmbrecht is the Company's CFO and Senior Vice President. CC ¶¶ 19-20.  
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38 Plaintiff was appointed Lead Plaintiff in this action on June 23, 2011 and  
 39 allegedly purchased Itron securities between April 28, 2010 and February 16,  
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44 <sup>2</sup> For purposes of this motion, Defendants assume, as they must, but do not  
 45 concede, the truth of Plaintiff's allegations in the Consolidated Complaint.  
 46  
 47

1 2011 (the "Class Period"). CC ¶ 17; ECF No. 11. Plaintiff purportedly asserts  
 2 claims on behalf of a class of persons who purchased or otherwise acquired Itron  
 3 securities during the Class Period. CC ¶¶ 1, 25.  
 4  
 5  
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 7

8 **B. Itron's February 16, 2011 Announcement.**  
 9

10 On February 16, 2011, Itron announced 2010 revenue of \$2.26 billion and  
 11 net income of \$105 million. Knowles Decl., Ex. A at 5-6. At the same time,  
 12 Itron reported that it was restating its financial results for the first three quarters  
 13 of 2010 (the "Restatement"). CC ¶ 3. Itron reported that it was restating its first  
 14 three quarters "primarily to defer revenue that had been incorrectly recognized on  
 15 one contract due to a misinterpretation of an extended warranty obligation. The  
 16 effect was to reduce revenue and earnings in each of the first three quarters of the  
 17 year." Knowles Decl., Ex. A at 5; CC ¶ 72. During Itron's February 16, 2011  
 18 earnings conference call, Mr. Helmbrecht stated that the Restatement related only  
 19 to premature recognition of revenue, "will not impact the total amount of revenue  
 20 recognized over the life of the contract," and had "no impact on cash flow, as we  
 21 are receiving payment for the extended warranty." Knowles Decl., Ex. B at 21.  
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38 The Restatement: (1) reduced Itron's revenue for the first three quarters of  
 39 2010 from approximately \$1.644 billion to approximately \$1.638 billion—a  
 40 reduction of \$6.1 million, or 0.37%, in revenue; (2) reduced Itron's net income  
 41 over that period from \$82.8 million to \$78.2 million, a reduction of \$4.6 million,  
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1 or 5.5%; and (3) reduced Itron's total basic earnings-per-share over that period  
 2  
 3 from \$2.06 to \$1.94—a reduction of \$0.12, or 5.8%. CC ¶ 68. The Restatement  
 4  
 5 did not result in any change in total cash provided by Itron's operating activities  
 6  
 7 nor did it affect the total extended warranty revenue Itron expected to receive  
 8  
 9 from this contract. Knowles Decl., Ex. A at 11. Thus, as the Consolidated  
 10  
 11 Complaint recognizes, the Restatement merely resulted in a deferral of \$6.1  
 12  
 13 million in accrued revenue—0.37% of the total revenue for that period—related  
 14  
 15 to an extended warranty purchased by a single customer. CC ¶ 72.  
 16  
 17

18  
 19 Plaintiff acknowledges that, pursuant to relevant accounting standards, a  
 20  
 21 restatement is only material if it exceeds a 5% "rule of thumb" and, viewed with  
 22  
 23 respect to net income and basic earnings-per-share, the Restatement *barely*  
 24  
 25 exceeds that threshold here. CC ¶ 92(c). Plaintiff alleges that Itron's stock price  
 26  
 27 declined by \$6.33 per share after disclosure of the Restatement but ignores that,  
 28  
 29 on February 16, 2011, Itron also disclosed 2011 earnings guidance that was lower  
 30  
 31 than analyst expectations. Knowles Decl., Ex. B at 24 ("2011 [revenue] guidance  
 32  
 33 is essentially down sequentially"); *id.* at 26 ("Just to clarify, your guidance for  
 34  
 35 2011 assumes sequential decline in both North America and international  
 36  
 37 business, or is it just one or the other?").  
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1 On February 24, 2011, Itron released its 2010 annual results, which  
 2 incorporated the restated financial results for the relevant three quarters in 2010.  
 3  
 4 See CC ¶ 5 n.4.  
 5  
 6

### 7 **C. Plaintiff's Claims.**

8 Plaintiff alleges two causes of action against Defendants: first, for  
 9 securities fraud under section 10(b) of the Securities Exchange Act of 1934  
 10 ("Exchange Act") and Securities and Exchange Commission ("SEC") Rule 10b-5  
 11 promulgated thereunder; and second, for control person liability under section  
 12 20(a) of the Exchange Act. CC ¶¶ 3, 109-16, 117-21.  
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## 22 **III. ARGUMENT**

### 23 **A. The PSLRA Imposes a Heightened Pleading Standard.**

24 "To survive a motion to dismiss, a complaint must contain sufficient  
 25 factual matter, accepted as true, to 'state a claim to relief that is plausible on its  
 26 face.' A claim has facial plausibility when the plaintiff pleads factual content that  
 27 allows the court to draw the reasonable inference that the defendant is liable for  
 28 the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S. Ct. 1937, 1949  
 29 (2009) (citations omitted). To survive a motion to dismiss, Plaintiff must plead  
 30 "more than labels and conclusions, and a formulaic recitation of the elements of a  
 31 cause of action will not do." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555  
 32 (2007). Thus, a court need not accept as true conclusory allegations,  
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1 unreasonable inferences or unwarranted deductions of fact in the complaint.

2  
3 *Clegg v. Cult Awareness Network*, 18 F.3d 752, 754-55 (9th Cir. 1994).

4  
5 To state a claim for securities fraud under section 10(b), a plaintiff must  
6  
7 adequately plead "(1) a material misrepresentation or omission by the defendant;  
8  
9 (2) scienter; (3) a connection . . . [with] the purchase or sale of a security; (4)  
10  
11 reliance . . .; (5) economic loss; and (6) loss causation." *Stoneridge Inv. Partners,*  
12  
13 *LLC v. Scientific Atlanta, Inc.*, 552 U.S. 148, 157 (2008). "At the pleading stage,  
14  
15 a complaint stating claims under section 10(b) and Rule 10b-5 must satisfy the  
16  
17 dual pleading requirements of Federal Rule of Civil Procedure 9(b) and the  
18  
19 PSLRA." *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 990 (9th Cir.  
20  
21 2009). Rule 9(b) requires that "[i]n alleging fraud . . . a party must state with  
22  
23 particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b).

24  
25 Additionally, the PSLRA requires that scienter be pled with particularity.  
26  
27 *Zucco*, 552 F.3d at 990; *Ronconi v. Larkin*, 253 F.3d 423, 429 (9th Cir. 2001).  
28  
29 Congress enacted the PSLRA to "eliminate abusive securities litigation and  
30  
31 particularly to put an end to the practice of pleading 'fraud by hindsight.'" *In re*  
32  
33 *Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1084-85 (9th Cir. 2002) (citation  
34  
35 omitted). The only fact alleged to support Plaintiff's fraud theory here is the  
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37 Restatement itself, which is exactly the type of fraud-by-hindsight claim that the  
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39 PSLRA was intended to eliminate.  
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**B. Plaintiff's Allegations Do Not Raise the Required Strong Inference of Scienter.<sup>3</sup>**

The PSLRA requires that Plaintiff allege "with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Desserault v. Yakima Chief Prop. Holdings, LLC*, No. CV-09-3055-RMP, 2010 WL 2232945, at \*6 (E.D. Wash. June 3, 2010) (quoting *Zucco*, 552 F.3d at 990)); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-94 & n.12 (1976) (defining "scienter" as a "mental state embracing an intent to deceive, manipulate, or defraud"). At a minimum, to avoid dismissal of the Consolidated Complaint, Plaintiff must plead particular facts giving rise to a strong inference of deliberate recklessness. *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 979 (9th Cir. 1999); *see also Yakima Chief*, 2010 WL 2232945, at \*6. "[D]eliberate

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<sup>3</sup> The PSLRA requires that Plaintiff specify each statement alleged to have been misleading and the reason why each such statement is misleading. 15 U.S.C. § 78u-4(b)(1). Here, the alleged misleading statements are Itron's unaudited financial statements for the first three quarters of 2010, disclosures concerning Itron's internal controls, and SOX certifications signed by the Individual Defendants. CC ¶¶ 38-39, 42, 45-46, 49, 52-53, 55, 59-60. Although Defendants do not concede the existence of any material misstatements, in this motion Defendants address only Plaintiff's failure to meet the scienter pleading requirement. Because the Consolidated Complaint fails to satisfy the scienter pleading requirement, it is not necessary to address the false statement element.

recklessness" is "'a form of intentional or knowing misconduct.'" *Zucco*, 552 F.3d at 991 (quoting *In re Silicon Graphics*, 183 F.3d at 976). To determine whether a plaintiff has alleged facts giving rise to a "strong inference" of scienter, the court is to consider plausible, nonculpable explanations for defendants' conduct in addition to any inferences favorable to plaintiff. *Tellabs Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 323 (2007). "An inference of fraudulent intent may be plausible, yet less cogent than other, nonculpable explanations for the defendant's conduct." *Id.* at 314. Evidence of scienter that is merely "reasonable" or "permissible" is insufficient to defeat a motion to dismiss. *Id.* at 324. A plaintiff must allege an inference of scienter that is both "cogent" and "at least as compelling as any opposing inference one could draw from the facts alleged." *Id.*

The Consolidated Complaint fails to raise a strong inference that the Individual Defendants acted with scienter because none of the reasonable inferences to be drawn from the facts alleged come close to demonstrating that the Individual Defendants had any intent to engage in fraud. The facts alleged do not provide a recognizable motivation for committing fraud—Plaintiff's fraud theory simply makes no sense. The competing, non-culpable explanation—that the Individual Defendants innocently discovered an accounting error regarding the timing of the recognition of extended warranty revenue—is much more plausible.

1 Plaintiff unsuccessfully relies on the following allegations to attempt to  
 2 plead the required strong inference of scienter: (1) Itron's issuance of the  
 3 Restatement evidences scienter, CC ¶¶ 92(a)-(e), 93; (2) the Restatement related  
 4 to a "major" and "importan[t] large contract," and therefore the Individual  
 5 Defendants had to know about the improper accounting, CC ¶¶ 5-7, 81-87; (3) the  
 6 Individual Defendants signed SOX certifications stating that the Company  
 7 complied with Generally Accepted Accounting Principles ("GAAP") and had  
 8 adequate internal controls which would have alerted them to the accounting error,  
 9 CC ¶¶ 60, 88-91, 94-95; and (4) the Individual Defendants had motive to  
 10 artificially inflate Itron's earnings to "allay investor concern over Itron's future  
 11 financial results" in order to increase their personal compensation and incentive  
 12 awards, CC ¶¶ 81, 96-99. As discussed below, these allegations—whether  
 13 standing alone or viewed holistically—are conclusory, based on speculation, and  
 14 entirely insufficient to establish the strong inference of scienter required by the  
 15 PSLRA.

### 1. The Restatement Itself Does Not Create a Strong Inference of Scienter.

16 Given that Plaintiff has alleged no facts from which to infer that the  
 17 Individual Defendants intentionally overstated extended warranty revenue by \$6.1  
 18 million, Plaintiff resorts to the simple but insufficient assertion that the issuance  
 19 of the Restatement itself provides a basis from which to strongly infer scienter.

1 CC ¶¶ 92(a)-(e), 93 ("Itron's Restatement Supports Scienter"). But contrary to  
 2 Plaintiff's claim, a restatement does not equal fraud, and courts have consistently  
 3 held that the fact of a restatement of financial results does not alone raise a strong  
 4 inference of scienter. *E.g.*, *Zucco*, 552 F.3d at 1000 ("[T]he mere publication of a  
 5 restatement is not enough to create a strong inference of scienter."); *In re Worlds*  
 6 *of Wonder Sec. Litig.*, 35 F.3d 1407, 1426 (9th Cir. 1994) (same); *In re Software*  
 7 *Toolworks Inc.*, 50 F.3d 615, 627-28 (9th Cir. 1994) (same).<sup>4</sup> When pleading

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20  
 21 <sup>4</sup> Plaintiff attempts to bolster its assertion that a financial restatement is  
 22 sufficient to allege scienter by mischaracterizing a section of a 2002 *amicus*  
 23 *curiae* brief filed by the SEC. *See* CC ¶¶ 70 n.11, 93. First, Plaintiff fails to  
 24 acknowledge that the PSLRA's heightened pleading requirements apply only to  
 25 *private* actions and do not apply to claims brought by the SEC. *E.g.*, *SEC v.*  
 26 *Berry*, 580 F. Supp. 2d 911, 920-21 (N.D. Cal. 2008) (concluding that SEC faces  
 27 a lower bar for pleading scienter than private plaintiffs under the PSLRA).  
 28 Second, in the brief, the SEC states that in its securities fraud enforcement  
 29 actions, it attempts to use restated financial statements in part to prove defendants'  
 30 scienter. *See* SEC Brief as *Amicus Curiae* Regarding Defendants' Motion in  
 31 *Limine* to Exclude Evidence of the Restatement and Restatement Report, *In re*  
 32 *Sunbeam Sec. Litig.*, No. 98-cv-8258-DMM, at 1 (S.D. Fla. Feb. 22, 2002) ("SEC

1 irregularities in revenue recognition, a plaintiff must allege enough to allow the  
 2 court to "discern whether the alleged GAAP violations were minor or technical in  
 3 nature, or whether they constituted widespread and significant inflation of  
 4 revenue." *Alaska Elec. Pension Fund v. Adecco S.A.*, 434 F. Supp. 2d 815, 822  
 5 (S.D. Cal. 2006) (citation and internal quotations omitted), *aff'd sub nom, In re*  
 6 *Adecco S.A. Sec. Litig.*, 256 Fed. Appx. 74 (9th Cir. 2007). A court may infer  
 7 scienter "[w]hen there are substantial allegations that the violations were of the  
 8 latter variety[.]" *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248,  
 9 1273 (N.D. Cal. 2000) (scienter adequately pled where defendants deleted critical  
 10 financial data during audits, were terminated for cause, and revenue inflation  
 11 exceeded 25% in some quarters).

12 Since courts will not infer scienter based simply on the issuance of a  
 13 restatement, Plaintiff attempts to plead around this deficiency in the Consolidated  
 14 Complaint by offering the conclusory allegation that this Restatement shares

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15 Brief"), available at <http://www.sec.gov/litigation/briefs/sunbeam.htm>. That the  
 16 SEC may seek to admit restated financial statements into evidence does not mean,  
 17 as Plaintiff urges, that the SEC "*often finds*" that the persons responsible for  
 18 restatements acted with scienter. *See id.* (emphasis added). Moreover, later in its  
 19 brief, the SEC admits that it would be "improper" for a jury to infer scienter  
 20 solely from the fact and magnitude of a restatement. SEC Brief at 10.

1 certain characteristics with other restatements on which a handful of courts have  
 2 partially relied to provide support for an inference of scienter. But in terms of  
 3 substance, size and duration, this Restatement is easily distinguishable from those  
 4 other restatements. First, this Restatement did not involve improper or fictitious  
 5 revenue; instead, it related merely to the timing of recognition of the extended  
 6 warranty revenue. CC ¶ 72. Plaintiff does not—and cannot—allege that the  
 7 revenue at issue will not be properly recognized by the Company in the future.  
 8 To the contrary, Itron expects to receive the full amount of the extended warranty  
 9 revenue attributable to the contract over the life of the contract. Second, the  
 10 amount at issue in the Restatement is, at best, *de minimis*. For the three  
 11 applicable quarters, the Restatement reduced total revenue by 0.37%; for each  
 12 quarter alone, the restatement reduced revenue by 0.33% (Q1), 0.37% (Q2), and  
 13 0.40% (Q3). CC ¶ 68. Even Plaintiff recognizes that the Restatement barely  
 14 satisfies the 5% materiality rule of thumb, and to meet that threshold, Plaintiff  
 15 focuses on net income and earnings-per-share rather than revenue. CC ¶ 92(c).

16  
 17 Courts in the Ninth Circuit routinely refuse to infer a strong inference of  
 18 scienter based on the issuance of much larger and broader financial restatements  
 19 than the one at issue here. For example, in *DSAM Global Value Fund v. Altris*  
 20 *Software, Inc.*, 288 F.3d 385, 387 (9th Cir. 2002), the court affirmed dismissal  
 21 because it found no basis to infer scienter where a restatement of financial results

1 for an entire year reduced net income from a \$2.4 million *profit* to a \$2.5 million  
 2 *loss*—a 204% adjustment. And in *In re VeriFone Holdings, Inc. Securities*  
 3 *Litigation*, No. C#07-6140#MHP, 2011 WL 1045120, at \*3 (N.D. Cal. Mar. 22,  
 4  
 5 2011), VeriFone restated three quarters of financial results, reducing operating  
 6 income over that period by 129%. Nevertheless, the court granted VeriFone's  
 7 motion to dismiss, finding that plaintiffs' arguments "regarding the fact or size or  
 8 duration of the restatement [are] insufficient to establish scienter." *Id.* at \*17; *see*  
 9 *also Curry v Hansen Med., Inc.*, No. 5:09-cv-05094-JF (HRL), 2011 WL  
 10 3741238, at \*2, \*6 (N.D. Cal. Aug. 25, 2011) (rejecting plaintiffs' scienter  
 11 allegations based on financial restatement covering 2008 year end results and  
 12 quarterly results for five quarters due to lack of "specific facts" alleging that the  
 13 accounting violations were "so egregious" that defendants "must have been aware  
 14 of them"). The Restatement is consistent with a "minor or technical" GAAP  
 15 violation, and there are no allegations that the Restatement resulted in a  
 16 "significant inflation of revenue" or that any accounting issues were  
 17 "widespread." *Alaska Elec. Pension Fund*, 434 F. Supp. 2d at 822.

18  
 19 The cases in which courts have credited a restatement—along with other  
 20 particularized allegations absent here—as a basis to infer scienter are so  
 21 distinguishable from the facts alleged in the Consolidated Complaint that they  
 22 deserve little mention. For example, in a recent decision from the Western  
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1 District of Washington, the court found scienter adequately pled where plaintiffs  
 2 alleged that fourteen separate accounting violations, including artificial inflation  
 3 of revenue and earnings by concealing liabilities, which resulted in a restatement  
 4 that covered three years and reduced net income and earnings-per-share by more  
 5 than 150%. *Richard v. Nw. Pipe Co.*, No C9-5724RBL, 2011 WL 3813073, at \*1  
 6 (W.D. Wash. Aug. 26, 2011). These allegations of a "drastic" restatement were  
 7 supported by additional scienter allegations that are absent here. For instance,  
 8 plaintiffs alleged that, despite defendants' claims that the company's revenue  
 9 recognition practices were "open and notorious," individual defendants "each  
 10 made an inconsistent statement about the company's revenue recognition  
 11 practices" that were implicated by the restatement. *Id.* at \*4.

12 Here, Plaintiff alleges only a single accounting error resulting in a *de*  
 13 *minimis* change in revenue and other financial metrics and which involved only  
 14 the timing of revenue recognition and not the existence of the revenue. Plaintiff  
 15 fails to allege a single fact from which to infer that the Individual Defendants  
 16 knew of the accounting error prior to the discovery leading to the Restatement.  
 17 *See Worlds of Wonder*, 35 F.3d at 1425-26 (rejecting as evidence of scienter an  
 18 expert's testimony that the error was "so obvious" that the accounting firm "must  
 19 have been aware of it" because it was "not based on specific facts that shed light  
 20 on the mental state of [the accountant's] auditors") (citation and internal

1 quotations omitted); *Curry*, 2011 WL 3741238, at \*6 (rejecting scienter where it  
 2 was "not apparent from the specific facts alleged in the [complaint] that the  
 3 accounting mistakes made by [the company] here were so egregious that the  
 4 Individual Defendants must have been aware of them").  
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10 The most plausible inference to be drawn from the facts alleged is that the  
 11 Restatement is the result of the innocent discovery of a technical accounting error  
 12 regarding timing for recognition of extended warranty revenue. There is nothing  
 13 about the announcement of the Restatement itself from which it is possible to  
 14 strongly infer scienter on the part of the Individual Defendants.  
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 22 **2. The Individual Defendants' Positions at the Company and the**  
 23 **"Importance" of the Contract at Issue in the Restatement Do**  
 24 **Not Raise a Strong Inference of Scienter.**  
 25

26 Given the lack of any alleged facts connecting the Individual Defendants  
 27 with any contemporaneous knowledge of the improperly recognized extended  
 28 warranty revenue, Plaintiff resorts to another purely speculative and conclusory  
 29 scienter allegation: that because of their positions with the Company and because  
 30 the contract at issue was so important to Itron, the Individual Defendants must  
 31 have known about the associated accounting error. CC ¶¶ 22, 82. But allegations  
 32 that a fact or transaction is so crucial that management must have been aware of it  
 33 do not raise a strong inference of scienter. *See, e.g., Zucco*, 552 F.3d at 1000  
 34 ("We have previously found inadequate complaints alleging that 'facts critical to a  
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1 business's core operations or an important transaction generally are so apparent  
 2 that their knowledge may be attributed to the company and its key officers.")  
 3 (quoting *In re Read-Rite Corp.*, 335 F.3d 843, 848 (9th Cir. 2003)); *see also S.*  
 4  
 5 *Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 784-85 (9th Cir. 2008) (allegations  
 6 regarding management's general awareness of company's business do not  
 7 establish scienter "absent some additional allegation of specific information  
 8 conveyed to management and related to the fraud") (citation and internal  
 9 quotations omitted). Not only does Plaintiff rely on a discredited basis to attempt  
 10 to establish the required strong inference of scienter, but in doing so, Plaintiff  
 11 inappropriately conflates the contract's importance to the Company with the  
 12 extended warranty revenue accounting issue that is the subject of the  
 13 Restatement. Even if the allegations were sufficient to show that the Individual  
 14 Defendants knew about the contract, there are no allegations from which to infer  
 15 that the Individual Defendants had any knowledge of or involvement in extended  
 16 warranty revenue recognition matters related to that contract.

17  
 18 It is also noteworthy to contrast the allegations in the Consolidated  
 19 Complaint with those in the two cases in which the Ninth Circuit has at least  
 20 partially credited the core operations theory. In *Berson v. Applied Signal*  
 21 *Technology, Inc.*, 527 F.3d 982, 988 (9th Cir. 2008), plaintiffs alleged that  
 22 Applied Signal's CEO and CFO must have been aware that four of the company's

1 primary clients had issued "stop-work" orders halting substantial portions of the  
 2 company's work. The court concluded that management must have been aware of  
 3 the stop-work orders based on: (i) the "temporal proximity" of the allegedly  
 4 the stop-work orders based on: (i) the "temporal proximity" of the allegedly  
 5 misleading statement and the company's public admission of the stop-work order  
 6 two weeks later, *id.* at 988 n.5; (ii) allegations concerning specific management  
 7 meetings, described by a confidential witness<sup>5</sup>, regarding one stop-work order,  
 8 *id.*; (iii) the allegation that the third stop-work order caused the company to  
 9 reassign 50-75 employees, resulting in one of the company's physical facilities  
 10 becoming a "ghost town," *id.*; and (iv) the allegation that the fourth stop-work  
 11 order required the company to complete "massive volumes of paperwork," *id.*  
 12 Taken together, the court found these allegations "prominent enough that it would  
 13 be 'absurd to suggest' that top management was unaware of" the stop-work orders.  
 14 *Id.* at 989 (citing *No. 84 Employer-Teamster Joint Council Pension Trust Fund v.*  
 15 *Am. W. Holding Corp.*, 320 F.3d 920, 943 n.1 (9th Cir. 2003)).

16 Similarly, in *America West*, the director defendants claimed that they were  
 17 unaware of maintenance problems that led to an investigation by the Federal  
 18 Aviation Administration ("FAA") because these were "purely management  
 19 issues" that never reached the board. 320 F.3d at 943 n.21. Plaintiffs alleged the

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<sup>5</sup> Unlike in *Berson*, the Consolidated Complaint does not cite to any  
 alleged confidential witnesses.

1 existence of internal reports and charts relating to maintenance problems and  
 2 meetings with and letters from the FAA regarding the maintenance problems. *Id.*  
 3 at 942. The court concluded that any assertion that the director defendants were  
 4 unaware of the investigation was "patently incredible" in light of these allegations  
 5 because it was "absurd to suggest" that the directors did not discuss these issues,  
 6 "especially considering the fact that the FAA had indicated that it was considering  
 7 penalties of up to \$11 million." *Id.* at 943 n.21.  
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10 *Berson and America West* provide a strong contrast to the allegations here.  
 11 Plaintiff does not allege that the Individual Defendants received any specific,  
 12 contemporaneous information regarding the premature revenue recognition—  
 13 much less "internal reports" regarding the alleged accounting error, "letters . . .  
 14 regarding the severity of the [accounting] problems" or "charts documenting the  
 15 [accounting] difficulties." *Id.* at 942; *see, e.g.*, CC ¶ 22 (alleging only that  
 16 "because of their position" the Individual Defendants had "access to material non-  
 17 public information," but failing to identify with particularity any such  
 18 information). The Consolidated Complaint does not allege any facts regarding  
 19 any meetings concerning revenue recognition for the contract at issue, names of  
 20 those who attended any such meetings, or information about what was discussed.  
 21 The Consolidated Complaint cannot raise the required strong inference of scienter  
 22 simply by speculating as to what the Individual Defendants must have known  
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1 because the contract was significant to the Company. Plaintiff's allegations that  
 2 the contract was "so important" that the extended warranty revenue arising out of  
 3 that contract could not have been innocently misstated and that the misstatement  
 4 was so central to Itron's "core operations" that the Individual Defendants must  
 5 have known about it fail to raise the required strong inference of scienter.  
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12 **3. The Individual Defendants' Signatures on SOX Certifications Do**  
 13 **Not Create a Strong Inference of Scienter.**  
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16 Plaintiff's reliance on the allegation of signatures on SOX certifications  
 17 also provides no basis from which to strongly infer scienter. Plaintiff alleges that  
 18 the Individual Defendants' mandatory certifications of Itron's financial statements  
 19 and internal controls pursuant to SOX "clearly would have alerted Defendants to  
 20 the presence of the accounting misstatements and lapse in internal controls  
 21 described herein." CC ¶ 94. Plaintiff simply asserts—without any supporting  
 22 factual allegations—that the accounting error was so apparent that failure to  
 23 discover it shows that "the Defendants knew or recklessly disregarded that the  
 24 SOX certifications they signed were false." *Id.*  
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37 Courts have repeatedly rejected this type of allegation because it would  
 38 automatically establish scienter where a company restated results. *See Zucco*, 552  
 39 F.3d at 1003-04 ("Boilerplate language in a corporation's 10-K form, or required  
 40 certifications under Sarbanes-Oxley section 302(a) . . . add nothing substantial to  
 41 the scienter calculus."). Mandatory SOX certifications are probative of scienter  
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1 only when combined with specific allegations demonstrating "'an extreme  
 2 departure from the standards of ordinary care.'" *Id.* at 991 (quoting *Silicon*  
 3 *Graphics*, 183 F.3d at 976); *see also Glazer Capital Mgmt., LP v. Magistri*, 549  
 4 F.3d 736, 747 (9th Cir. 2008) (requiring particularized allegations that defendant  
 5 was "severely reckless") (citation and internal quotations omitted). Here, there  
 6 are no allegations from which to conclude that the Individual Defendants were  
 7 reckless—let alone "severely" reckless—in connection with the extended  
 8 warranty revenue recognition error in the single contract at issue here. The Court  
 9 cannot infer scienter from Plaintiff's conclusory SOX certifications allegations.  
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 22 **4. Plaintiff's Motive and Opportunity Allegations Fail to Raise the**  
 23 **Required Strong Inference of Scienter.**  
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25 With no specific—let alone detailed and particularized—facts on which to  
 26 establish a strong inference of scienter, Plaintiff asks the Court to strongly infer  
 27 scienter based on the Individual Defendants' supposed motive and opportunity to  
 28 engage in the fraud alleged in the Consolidated Complaint. Plaintiff alleges that  
 29 Individual Defendants "had ultimate responsibility for the preparation of Itron's  
 30 financial statements," CC ¶ 88, "were motivated to inflate revenue and earnings  
 31 during the Class Period in order allay [sic] investor concern over Itron's future  
 32 financial results," CC ¶ 81, and received compensation "dependent upon Itron's  
 33 posting favorable financials," CC ¶ 96. But courts have repeatedly held that such  
 34 general allegations of motive and opportunity are insufficient to establish the  
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1 required strong inference of scienter. *Yakima Chief*, 2010 WL 2232945, at \*4  
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 3 ("[A]lthough facts showing . . . a motive to commit fraud and opportunity to do  
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 5 so may provide some reasonable inference of intent, they are not sufficient to  
 6  
 7 establish a strong inference of deliberate recklessness." (quoting *Zucco*, 552 F.3d  
 8  
 9 at 991)); *see also South Ferry*, 542 F.3d at 782 (same); *Metzler Inv. GMBH v.*  
 10  
 11 *Corinthian Colls., Inc.*, 540 F.3d 1049, 1069 (9th Cir. 2008) (same). Not only are  
 12  
 13 the motive and opportunity allegations here insufficient to raise the strong  
 14  
 15 inference of scienter, but the only plausible inference to be drawn from the facts  
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 17 alleged is that the Individual Defendants had *absolutely no economic motive* to  
 18  
 19 commit the alleged fraud. That is, this alleged fraud makes no sense.  
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23  
 24 **a. The Individual Defendants Received No Financial Benefit**  
 25 **from the Misstated Financial Results.**  
 26

27 Plaintiff's allegations that the Individual Defendants benefited personally  
 28  
 29 from the misstated results are legally deficient and factually inaccurate. CC ¶¶  
 30  
 31 96-99 ("Executive Compensation"). *See Zucco*, 552 F.3d at 1005 ("If simple  
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 33 allegations of pecuniary motive were enough to establish scienter, 'virtually every  
 34  
 35 company in the United States that experiences a downturn in stock price could be  
 36  
 37 forced to defend securities fraud actions.'") (quoting *Lipton v. Pathogenesis*  
 38  
 39 *Corp.*, 284 F.3d 1027, 1038 (9th Cir. 2002)).  
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44 As a basis on which to attempt to plead facts sufficient to strongly infer  
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 46 scienter, Plaintiff alleges that the Individual Defendants had a financial incentive  
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1 or motivation to misstate revenue for the first three quarters of 2010 by 0.37%.  
 2  
 3 CC ¶ 99. But the assertion is demonstrably false based on documents referenced  
 4  
 5 in the Consolidated Complaint. The portion of the Individual Defendants'  
 6  
 7 compensation that is tied to Itron's financial results is based on Itron's *annual*  
 8  
 9 financial results and was calculated in 2011 taking into account the restated  
 10  
 11 quarterly financials.<sup>6</sup> Because Itron discovered the accounting error in the fourth  
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 13 quarter before issuing year-end financial results (and used the corrected quarterly  
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 15 results in its year-end filing), the Individual Defendants' incentive awards were  
 16  
 17 not impacted by the allegedly fraudulent financial statements extant during the  
 18  
 19 first three quarters of 2010.<sup>7</sup> Accordingly, the allegations in the Consolidated  
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26  
 27 <sup>6</sup> The Individual Defendants received two forms of compensation based on  
 28  
 29 Itron's financial results: (i) annual cash incentives, and (ii) long-term incentives  
 30  
 31 (stock and option awards). Knowles Decl., Ex. C at 61-62. Annual cash  
 32  
 33 incentives "are based on the Company's *annual* financial performance" and  
 34  
 35 "designed to incentivize and reward attainment of *annual* business and financial  
 36  
 37 goals." *Id.* at 66 (emphasis added). Similarly, the Individual Defendants' long-  
 38  
 39 term incentive awards were determined in February 2011 based on Itron's annual  
 40  
 41 results which included the three restated quarters. *Id.* at 68.  
 42

43 <sup>7</sup> Further, even if Itron had computed the Individual Defendants' cash or  
 44  
 45 long-term incentive awards based on the misstated results, the error would not  
 46  
 47 have affected the Individual Defendants' 2010 incentive awards. The Individual

1 Complaint regarding the Individual Defendants' financial motive to inflate Itron's  
2 financial results are demonstrably false and cannot support an inference of  
3 scienter—let alone the required strong inference. There are no allegations in the  
4 Consolidated Complaint from which to infer that the Individual Defendants had  
5 any personal financial incentive to overstate revenue in the first three quarters of  
6 2010. The fraud theory simply makes no sense.  
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16 Defendants' incentive compensation plans provided for different levels of  
17 potential awards based on Itron's annual financial performance: no award if  
18 Itron's annual results failed to meet the "threshold" level; 50% of an award  
19 amount if Itron's annual results met the "threshold" level; 100% of an award  
20 amount if Itron's annual results met the "target" level; and 200% of an award  
21 amount if Itron's annual results met or exceeded the "maximum" level. Knowles  
22 Decl., Ex. C at 67-68. Once Itron's annual results satisfied the "maximum" level,  
23 any improvement in Itron's annual financial performance no longer increased the  
24 Individual Defendants' incentive awards. For fiscal year 2010, Itron's annual  
25 financial results met the "maximum" level, qualifying Messrs. Unsworth and  
26 Helmbrecht for the maximum incentive awards. *Id.* Therefore, even if it had  
27 been included in the calculation of the Individual Defendants' 2010 incentive  
28 awards—which it was not—the additional \$6 million revenue overstatement and  
29 its effect on Itron's other financial metrics would not have impacted the amount of  
30 the Individual Defendants' incentive awards since Itron's restated financial results  
31 had already reached the "maximum" threshold.  
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**b. The Absence of Any Insider Stock Sales Refutes Any Inference of Scienter Based on "Motive and Opportunity."**

Notably absent from the Consolidated Complaint are the typical allegations that the Individual Defendants profited from the alleged fraud by selling Itron securities during the Class Period. The absence of allegations of insider sales "suggest[s] that there was no insider information from which to benefit" and may "rebut [] an inference of scienter." *Metzler*, 540 F.3d at 1067 & n.11 (quoting *Worlds of Wonder*, 35 F.3d at 1427); *see also Tripp v. Indymac Fin. Inc.*, No. CV07-1635-GW(VBKx), 2007 WL 4591930, at \*4 (C.D. Cal. Nov. 29, 2007) (finding that, where defendants sold no stock during the class period, the "inference of scienter is functionally negated"). And the lack of any insider sales is particularly significant because Messrs. Unsworth and Helmbrecht each had a substantial number of shares, 190,423 and 106,729, respectively, which they could have sold during the Class Period. Knowles Decl., Ex. C at 91.

Common sense dictates that if the Individual Defendants were engaged in a fraud to inflate the price of Itron stock, then surely there would have been some way for them to benefit financially. Here, neither of the Individual Defendants' compensation plans provided any such benefit, nor is either alleged to have sold a single share of stock. The lack of any compensation benefit related to the alleged fraud and the lack of stock sales support the conclusion that the Restatement was an innocent accounting error and that there is no fraud here.

1                   **5. Considered Holistically, Plaintiff's Scienter Allegations Do Not**  
 2                   **Raise an Inference of Scienter that Is Stronger than a**  
 3                   **Competing, Nonculpable Inference.**  
 4

5                   Plaintiff's allegations, which are inadequate to strongly infer scienter when  
 6 considered individually, fare no better when considered holistically. Although  
 7 *Tellabs* instructs the Court to view the Consolidated Complaint holistically, such  
 8 a comprehensive review "cannot transform a series of inadequate allegations into  
 9 a viable inference of scienter." *Zucco*, 552 F.2d at 1008. Indeed, "a plaintiff  
 10 cannot *avoid* dismissal by reliance on an isolated statement that stands in contrast  
 11 to a host of other insufficient allegations." *Metzler*, 540 F.3d at 1069 (citing  
 12 *Tellabs*, 551 U.S. at 310). Here, Plaintiff does not even offer a single "isolated  
 13 statement" that supports scienter. The Consolidated Complaint lacks any  
 14 particularized allegations regarding specific contemporaneous information  
 15 corroborating Plaintiff's allegations of fraudulent intent. But "[w]ithout any  
 16 corroborating facts, it is impossible to conclude that such allegations rest on more  
 17 than hind-sight speculation." *In re Vantive Corp.*, 283 F.3d at 1089. The holistic  
 18 evaluation does not save Plaintiff's inadequate scienter allegations.  
 19

20                   Under the "holistic" approach, the court must "consider the totality of  
 21 circumstances." *South Ferry*, 542 F.3d at 784. But "[e]ven if a set of allegations  
 22 may create an inference of scienter greater than the sum of its parts, it must still  
 23 be at least as compelling as an alternative innocent explanation." *Zucco*, 552 F.3d  
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1 at 1006. "The strength of an inference cannot be decided in a vacuum," and "a  
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3 court must consider plausible nonculpable explanations for the defendant's  
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5 conduct." *Tellabs*, 551 U.S. at 323-24. The Consolidated Complaint lacks  
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7 factual allegations that would permit any inference—let alone the required strong  
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9 inference—that the Individual Defendants acted with scienter.  
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11  
12 Rather, viewed from a "practical and common sense perspective," *South*  
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14 *Ferry*, 542 F.3d at 784, the competing nonculpable inference is far stronger, for  
15  
16 several reasons. First, the Individual Defendants received no personal  
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18 compensation benefit from the misstated results and are not alleged to have  
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20 engaged in any insider sales, undermining any motive they might have had to  
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22 engage in fraud. Second, the *de minimis* amount at stake in the Restatement—just  
23  
24 barely surpassing Plaintiff's own materiality rule of thumb only when considering  
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26 certain financial components of the Restatement—and the fact that the period  
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28 covered in the Restatement was only three fiscal quarters, are more consistent  
29  
30 with a mistake than an elaborate fraud scheme. Third, the Restatement did not  
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32 impact the amount of the extended warranty revenue that Itron would receive  
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34 over the length of the contract but related only to the timing of recognition of that  
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36 revenue. Fourth, the Restatement had no impact on the Company's cash position.  
37  
38 Fifth, Plaintiff has not alleged any details regarding extended warranty revenue  
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40 recognition or who at Itron knew about the error and when. Plaintiff also fails to  
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1 identify any specific information that demonstrates that the Individual Defendants  
 2 were involved in extended warranty revenue recognition issues, the accounting  
 3 error or its discovery. Sixth, although Plaintiff cites to analysts' reports  
 4 concerning Itron's long-term outlook prior to the Restatement, CC ¶¶ 34-35, the  
 5 Consolidated Complaint contains no allegations of any negative reaction to the  
 6 Restatement by those same analysts. It is reasonable to conclude that, if the  
 7 analysts believed that the Restatement was significant, they would have  
 8 commented on it, and Plaintiff would have alleged such negative comments.  
 9

10 The more plausible explanation arising from all of the facts alleged is that  
 11 Itron made an honest and innocent accounting error regarding a *de minimis*  
 12 amount of extended warranty revenue related to a single, complicated contract  
 13 and disclosed that error as soon as it was discovered. Accordingly, the allegations  
 14 in the Consolidated Complaint are insufficient to raise the required "strong  
 15 inference" of scienter, and the Consolidated Complaint should be dismissed.  
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 34 **C. The Consolidated Complaint Fails to State a Claim Under**  
 35 **Section 20(a) of the Exchange Act.**  
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37 To state a claim under section 20(a) of the Exchange Act, Plaintiff must  
 38 establish (1) a primary violation of the underlying securities laws, and (2) that  
 39 defendants exercised control over the primary violator. *Howard v. Everex Sys.,*  
 40 *Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000). In the absence of a sustainable claim  
 41 for violation of section 10(b), Plaintiff's claim for secondary liability under  
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1 section 20(a) fails. *Zucco*, 552 F.3d at 990. Here, the Consolidated Complaint  
 2 fails to plead a viable primary violation of section 10(b) of the Exchange Act and,  
 3 accordingly, Plaintiff's claim under section 20(a) should also be dismissed.  
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8 **D. Plaintiff Should Not Be Given Leave to Amend.**  
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10 The Court should dismiss the Consolidated Complaint with prejudice. In  
 11 the Ninth Circuit, the Court's "discretion to deny leave to amend is particularly  
 12 broad where [the] plaintiff has previously amended the complaint." *Allen v. City*  
 13 *of Beverly Hills*, 911 F.3d 367, 373 (9th Cir. 1990). Plaintiff has had every  
 14 opportunity to plead a viable securities fraud claim in its Consolidated Complaint  
 15 amending the initial complaint, and Plaintiff's failure to do so demonstrates that  
 16 any further pleading would be futile. *See In re Vantive Corp.*, 283 F.3d at 1097;  
 17 *In re Wet Seal, Inc. Sec. Litig.*, 518 F. Supp. 2d 1148, 1181 (C.D. Cal. 2007)  
 18 (denying leave to amend where plaintiffs had already amended complaint and did  
 19 not indicate additional facts they could allege). No matter how Plaintiff attempts  
 20 to embellish it, Plaintiff's fraud claim is based solely on the issuance of the  
 21 Restatement, which does not satisfy the scienter pleading standard. There is no  
 22 basis for providing another opportunity for Plaintiff to amend its complaint.  
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41 **IV. CONCLUSION**  
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43 For the foregoing reasons, Defendants respectfully request that the Court  
 44 dismiss the Consolidated Complaint with prejudice.  
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1  
2 DATED: October 21, 2011

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MEMORANDUM OF LAW IN SUPPORT OF  
MOTION TO DISMISS CONSOLIDATED  
COMPLAINT – 31

10145-6012/LEGAL21929582.1

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**CERTIFICATE OF SERVICE**

I hereby certify that on October 21, 2011, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF System which will send notification of such filing to the following:

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